

United States
COURT OF APPEALS
for the Ninth Circuit

OREGON-WASHINGTON PLYWOOD COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S REPLY BRIEF

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The debt of \$400,000.00 is definite and unconditional. It was incurred for a business purpose—the acquisition of timberland situated in the State of Oregon; it is evidenced by a purchase contract recognized and enforceable under the laws of Oregon as a common form of purchase price mortgage, and by a promissory note. The statement in respondent's brief (p. 12) reading "Both (referring to the purchase contract and the note)

provide that the \$400,000.00 balance was to be paid at the rate of \$5 per thousand feet * * * for all logs except wood logs cut and removed by the taxpayer or its agents during the previous calendar month" is not correct, and is misleading. In the contract (Ex. 1, R. 31) petitioner agreed unconditionally to pay \$500,000.00 for the timberland; \$100,000.00 was paid in cash on or prior to September 30, 1943, and petitioner's note (Ex. 2, R. 39) was given for the balance. The note reads in part:

"* * * the undersigned (petitioner) for value received promises to pay the order of Peterman Manufacturing Company the sum of Four Hundred Thousand Dollars (\$400,000.00) in lawful money of the United States of America."

The note was given for an agreed existing indebtedness of \$400,000.00. The promise to pay that specific amount was in no way qualified or made to depend upon any future condition or contingency. Had the note ended with the quoted part, the full amount would have been payable on demand.

The second clause reads:

"Payments on this note plus accrued interest at the rate of 3% per annum on deferred balance shall be made on the 15th day of each month beginning November 15, 1943."

The third clause reads:

"The basis of such principal payments to be \$5.00 per thousand feet * * * for all logs except wood logs cut and removed by purchaser (petitioner) or its agents during the previous calendar month * * *."

The last clause provides the means of determining the amount to be paid on the principal monthly and also served to protect the security reserved by the purchase contract. It in no way weakens or qualifies the antecedent promise to pay the full sum of \$400,000.00. The monthly payments were not for logs cut and removed, but were to apply on the gross indebtedness for the "timberland" including the land as well as the timber. The existing debt should be kept distinct from the method of determining the amount of the monthly payments. Clearly it was not the intention of the parties to limit petitioner's obligation to pay the full \$400,000.00 to the quantity of timber removed from the land. This is evident from the clause in the purchase contract providing that "no loss or destruction of, nor injury or damage to any part or all of the property * * * shall relieve the purchaser * * * from any of the obligations imposed on or assumed by it" (R. 33). There is a clear distinction between a promise to pay an existing debt of a specific amount without qualifications or conditions at a time to be determined by subsequent events, and a promise to pay a designated amount on the happening of specified events. When one promises to pay an existing debt in a fixed amount, as in this case, and the *time of payment* is to be determined by subsequent events and the events do not or for some reason cannot occur, the law implies an obligation to pay within a reasonable time (Authorities Appendix 2, pp. 30-35, petitioner's brief).

DEFINITION OF NOTE. The Tax Court in *Journal Publishing Co. v. Commissioner* (3 T.C. 518) defined a note within the meaning of section 719 R.C., as

“a written promise to pay a certain sum of money at a future time unconditionally.” That definition was quoted with apparent approval in *Consolidated Gold Acres Co. v. Commissioner*, 165 Fed. 2d 94 (C.A. 10). This note comes clearly within the definition promulgated by The Tax Court.

THE MORTGAGE. No attempt will be made to distinguish the Court decisions cited by Respondent on this subject. Congress did not attempt to define a mortgage, probably for the reason that the forms and nature differ in many of the states of the Union. In a few of the states the common law form which passes the title to the property mortgaged prevails with slight modifications. In some the form is provided by statute. In some the instrument passes the legal title and may provide the method of foreclosure. The form and effect vary as to detail in many of the states. One cannot say there is any general form. The form and effect of mortgages is regulated by the states in which the property is situated. The essential characteristic of all is that the instrument creates a lien on the property described therein for the security of a debt or the performance of some obligation which may be enforced against the property. Mortgages or liens on real property are construed and enforced according to the laws of the state in which the property is situated (See generally 41 C.J., pp. 273-280; 59 C.J.S., pp. 24-29; 36 Am. Jur., p. 690). Congress intended that any instrument which creates a lien on a taxpayer's real property to secure a debt of the taxpayer which may be treated and foreclosed as a mortgage by the courts of the state in which the property is situated, is a mortgage

within the meaning of section 719 R.C. The purchase contract, Exhibit 1, could, under the laws of Oregon, in the event of petitioner's failure to pay the debt, be foreclosed, the property sold and proceeds of sale applied on the debt, in exactly the same manner as any other form of a purchase price mortgage (See petitioner's brief, pp. 26-29). The fact that the mortgagee may have had the alternative remedy of a "strict" foreclosure does not make the instrument any the less a mortgage. The right to foreclose as a mortgage does not have to be the exclusive remedy.

**COURT DECISIONS RELIED UPON BY
RESPONDENT NOT APPLICABLE
TO THIS CASE**

In *Consolidated Gold Acres v. Commissioner*, 165 Fed. 2d 542, the obligation was not evidenced by a note. The Court held the contract not to be a mortgage under the Nevada laws; that the obligation to pay was not unconditional. In *Benard Realty Co. v. U. S.*, 188 Fed. 2d 861, the debt was not evidenced by a note, the Court held the purchase contract not to be a mortgage under the laws of Wisconsin where the property was situated; that the obligation to pay was not unconditional; that the vendor during the taxable year had the obligation of satisfying a mortgage outstanding against the property to be purchased; of paying the taxes on the property from funds to be contributed by the taxpayer, and conveying clear title. In *Frankel v. Commissioner*, 167 Fed. 2d 94, the obligation was not evidenced by a note and was

not unconditional. In the other cases cited, the facts differ materially from the facts in this case. It would only burden the Court to distinguish them in this brief.

When the purchase contract was executed, \$100,-000.00 paid on the purchase price and petitioner's note given for the balance, the purchase and sales contract was completed so far as the vendors and the payees of the note were concerned. Petitioner's obligation to pay the note became complete. Neither the vendors or the payees of the note had one thing to do until the note was paid in full.

ALTERNATIVE REMEDIES OF THE VENDORS

The fact that the vendors had the alternative remedy of declaring a forfeiture and recovering the property in the event of petitioner's failure to pay, instead of bringing suit to recover on the note, did not affect petitioner's liability on the note. The statute (Sec. 719 R.C.) does not require that the note or the mortgage must be the exclusive remedy of the creditor. The fact that the taxpayer owes a debt incurred for a business purpose and the debt is evidenced by either a note or mortgage, is all that is required. The Court cannot read into the statute that the taxpayer must go further and show that the owner of the mortgage or note has no other remedy or that the owner will enforce payment of same. Neither does the fact that the vendors might have had a strict foreclosure of the purchase contract instead

of exercising their right to have it foreclosed as a common form purchase mortgage deprive the instrument of the characteristics of a mortgage. The debt and the right to enforce payment through the instrumentality or a note or mortgage is all that is required.

NO QUESTION OF COMPUTATION OF THE TAX INVOLVED

Before this case reached The Tax Court counsel for petitioner and the Commissioner made a sincere effort to stipulate all the material facts and confine the issue to the point of whether the purchase contract and note, considered alone or in connection with the other stipulated facts, created and evidenced an indebtedness of the petitioner for borrowed invested capital within the meaning of section 719 of the Revenue Code. It is stipulated if they did, 50 per cent of the average daily balances owing on the indebtedness during the year 1944, was \$171,974.05 and during the year 1945, \$130,746.55, and there would be no deficiency excess profit tax. If they do not, there would be a deficiency as determined by the Commissioner in the amount of \$19,925.35, and if the deficiency should be affirmed by the Court it would result in an overassessment in petitioner's income tax for the year 1944 in the amount of \$9,321.80. There was never any question about the correctness of the computation of the tax. The sole question is whether the indebtedness, as above stated, was for borrowed invested capital within the meaning of the Code (R. 26-27). The sufficiency of the stipulation was not raised in The Tax

Court. There was no necessity for proving the quantity of timber removed from the land during the years 1944 or 1945 or at any time (pages 10 and 24, respondent's brief).

Respectfully submitted,

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